



United States Department of State

Washington, D.C. 20520

October 11, 1983

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(With Confidential Attachment)

MEMORANDUM FOR MR. DAVID E. PICKFORD
DEPARTMENT OF THE TREASURY

SUBJECT: SIG-IEP Review of Draft "Report of the U.S.-Japan
Working Group on Energy"

Attached is a draft "Report of the U.S.-Japan Working Group on Energy." The report is expected to be made public during the President's visit to Japan next month. Japanese officials are studying the draft, but understand that it remains an informal document for the moment. Under Secretary Wallis, in his capacity as Chairman of the U.S.-Japan Energy Working Group, has asked that this document be circulated for the information of participants in the SIG-IEP on October 13.

Covey

Charles Hill
Executive Secretary

Attachment:
As stated.

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Report of the US-Japan Working Group on Energy

(To be presented to President Reagan and Prime Minister Nakasone)

During the deliberations of the U.S.-Japan Energy Working Group, the two countries reviewed their energy relations in the context of the long-term energy prospects for the entire Pacific Basin, and the vital need of countries in the region for stable and secure supplies of energy. Both governments noted that although energy markets were relatively stable, they were not likely to remain so through the 1990's, and agreed that both countries should continue to diversify their sources of supply. With regard to its energy policy, Japan stated its intention to persevere in its endeavors to develop alternative energy sources, including coal and LNG.

The Opportunity

Energy cooperation can play a vital role in the long-term economic and security relationship between the United States and Japan. The energy sectors in the US and Japan are uniquely complementary: as a large importer of oil, gas and coal, Japan can benefit from the sizeable energy supply potential of the United States.

Expanded trade with the US will help Japan diversify its energy sources, thereby enhancing its energy security. The US will benefit by an increase in jobs dedicated to energy exports and by increased investment from abroad in the development of energy resources.

Both countries recognize that US energy exports will have to be competitively priced with alternatives and that purchase negotiations should be carried out through commercial channels.

Existing Energy Cooperation

Our two countries already benefit from a strong cooperative relationship in energy trade and in energy research and development:

- Over the previous four years, Japan has purchased 29% of its coal requirements from the US, including 31% of its metallurgical coal needs;

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- The US exports to Japan about a million tons per year of LNG and about 70,000 barrels per day of oil products;

- Japan has contracted for \$400 to 500 million per year of enrichment services from the US to support its nuclear program, which represents nearly 100% of Japanese requirements;

- The two countries engage in a number of joint R&D projects, including fast breeder reactors, fusion, high energy physics, geothermal energy and photosynthesis.

Potential for Enhanced Energy Cooperation

The Working Group found substantial potential for increased trade and investment in coal, oil and gas based on an assessment of global, US and Japanese energy situations:

- It was agreed, consistent with the conclusion of IEA Ministers in May 1983, that the Free World oil market, which is currently characterized by ample supplies and slack demand, is likely to tighten again. This reinforces the need for continued energy diversification to strengthen energy security.

- Forecasts of energy demand for Japan are currently being revised downward due to expectations of reduced economic growth, changes in industrial structure and the effects of energy conservation. However, since overall energy demand is expected to increase substantially between now and the end of the century, efforts will have to be made to find secure sources of all fuel types, striking a balance between energy security and cost considerations.

- The large energy reserve base of the United States will allow the US to meet about 90% of its energy needs through the year 2000. However, within the extensive mix of energy commodities produced in the United States, and across the wide range of U.S. regions, some commodities in some regions will be in substantial surplus. Thus, the U.S. will be in a position to accommodate sizeable energy exports. Development of US energy resources would be greatly enhanced by investments and long-term purchase commitments from major potential importers such as Japan.

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The Group examined the market for coal, oil and gas in Japan to the end of the century and the contribution which the US might make to Japanese requirements for each of these fuels:

- Japan's steam coal demand and imports are expected to rise steadily throughout the century, raising the prospect of significant increases in US imports if priced competitively with alternative supplies.

- The group noted favorably that examinations were underway of technical and economic aspects of several steam coal projects by the private companies concerned on both sides. Japan expressed the expectation that the examinations would be completed smoothly and that if the feasibility of the projects is confirmed, they would proceed to the development stage.

- Prospects for increased metallurgical coal imports have been dampened by lowered expectations for steel production. While there is therefore limited scope for increasing US exports to Japan in the short term, both sides expect that this trade will continue at a level consistent with those of recent years.

- Japan already has commitments to meet its expected natural gas needs through the early 1990s. Thereafter, opportunities exist for imports of LNG from the US, perhaps in significant quantities by the mid-1990s.

- Despite best efforts to diversify sources of energy, Japan will continue to rely heavily on imported oil to meet its energy needs. If legislative barriers can be overcome, the US has the potential to ship substantial quantities to Japan.

Recommendation

The Working Group recommends that the two governments agree to the following joint policy statement on further energy cooperation in oil, coal and gas. The Working Group further recommends that this policy statement be announced during President Reagan's November visit to Japan.

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Joint Policy Statement

1. Taking account of the energy prospects for the entire Pacific Basin, the two countries agree that the development of a close energy relationship between the US and Japan is a natural corollary to the close trade and security relationship which exists between the two countries;
2. They will continue to discuss and find ways of developing this relationship to the mutual benefit of both countries;
3. Both countries consider Alaska to be a particularly promising area for joint development of energy resources, and that both governments will encourage private sector discussions regarding the possibilities for such development.
4. With regard to trade in oil, gas and coal, we have agreed on the following next steps:
 - a. The US will continue to consult with the Congress with the aim of allowing limited exports of U.S. crude oil, which would increase economic incentives for U.S. oil production, and also help to diversify Japan's energy sources.
 - b. Japan noted the strong interest of private Japanese companies in a major study to explore the possibility of joint development of Alaskan natural gas resources. The US and Japan will encourage private industry in both countries to undertake now the feasibility studies necessary to determine the extent to which Alaskan natural gas can be jointly developed by US and Japanese interests.
 - c. With regard to metallurgical coal, both sides noted that the depressed state of world steel manufacturing had reduced demand for traded coal. Nevertheless, Japan expressed the intention of the Japanese steel industry not to lower purchases of U.S. coal below a level consistent with those of recent years. (1979 - 13.9 million metric tons; 1980 - 20.7 mmt; 1981- 23.7 mmt; 1982 - 19.8 mmt.)

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d. The US and Japan will encourage private industry in both countries to jointly develop mines and transportation systems to make American coal more competitive in the Japanese market and, concurrently, to discuss the conclusion of long-term coal contracts. Japan will endeavor to purchase more US coal as economic recovery proceeds. In particular, the Japanese government will encourage its industries to consider favorably purchases of U.S. steam coal to meet future demand not already covered by existing contracts.

e. As a first step toward achieving this goal, Japan will organize a high-level mission composed of representatives of major Japanese coal users to visit the U.S. to meet with major coal mining and transportation interests. The purpose of this mission will be to explore the possibility of expanding coal trade between the U.S. and Japan, and the possibility of conducting a major study of the opportunities for reducing the delivered price in Japan of U.S. coal in order to contribute to the smooth development of U.S.-Japan coal trade from a middle-to long-term perspective.

f. The United States Government has agreed to assist Japan and the U.S. private-sector to explore the possibility of expanding coal trade between the U.S. and Japan through reductions in the delivered cost of U.S. coal. At the same time, Japan will conduct an intensive study of the possibility of increasing the substitution of coal for oil in electrical generation.

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